

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 99-0570**

**Individual Income Tax  
For Tax Periods 1996-1997**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**I. Individual Income Tax—Assessment**

**Authority:** IC 6-8.1-5-1

Taxpayer protests the assessment of Individual Income tax.

**II. Tax Administration—Interest**

**Authority:** IC 6-8.1-10-1

Taxpayer protests the imposition of interest.

**III. Tax Administration—Fraud Penalty**

**Authority:** 6-8.1-10-4; 45 IAC 15-5-7

Taxpayer protests the imposition of a 100% Fraud Penalty.

**STATEMENT OF FACTS**

Taxpayer operates a tavern selling familiar name brand liquor, beer and wine. The Indiana Department of Revenue conducted a sales tax audit for the years 1996, 1997 and 1998, and individual income tax audit for the years 1996 and 1997. Taxpayer protested the resulting assessments, interest and penalties, while offering no supporting documentation. Taxpayer's representative (Power of Attorney (POA) on file) waived the administrative hearing. Taxpayer then appeared for the hearing, and the Department rescheduled the hearing to provide time for taxpayer and the POA to communicate with each other. The hearing officer also suggested that the taxpayer make copies of any records the Department should consider and send them in prior to the hearing. Taxpayer

called approximately three weeks before the hearing, to say that the records were in the mail. The Department of Revenue never received the records. This Letter of Findings is written based on the information contained in the file.

**I. Individual Income Tax—Assessment**

**DISCUSSION**

Taxpayer protests the assessment of Individual Income Tax for the years 1996 and 1997. The Department assessed taxpayer for additional Individual Income Tax after a Sales Tax audit determined that the taxpayer's business had more sales than previously reported. The Department refers to IC 6-8.1-5-1(a), which states:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

It has been determined that taxpayer underreported sales for a business owned by taxpayer. Sales Tax has been assessed on the increase of sales. It follows that an increase in sales would result in an increase in income, realized as profits from those sales. The auditor assessed Individual Income Tax on the unreported income. Taxpayer has provided no documentation to show that the Individual Income Tax assessment is incorrect.

**FINDING**

Taxpayer's protest is denied.

**II. Tax Administration—Interest**

**DISCUSSION**

Taxpayer asked the Department to reduce some of the interest associated with these assessments. IC 6-8.1-10-1(e) states:

Except as provided by IC 6-8.1-5-2(d)(2), the department may not waive the interest imposed under this section.

IC 6-8.1-5-2(d)(2) refers to the suspension of interest when an extension agreement is reached between a taxpayer and the Department. There was no such agreement in this case. Therefore, IC 6-8.1-5-2(d)(2) does not apply, and the Department may not waive the interest associated with these assessments.

**FINDING**

Taxpayer's protest is denied.

### **III. Tax Administration—Fraud Penalty**

#### **DISCUSSION**

Taxpayer asked the Department to waive some or all of the one hundred percent (100%) fraud penalty imposed along with these assessments. In establishing the fraud penalty, IC 6-8.1-10-4 provides:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, he is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100%) multiplied by:
  - (1) the full amount of the tax, if the person failed to file a return; or
  - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2 of this chapter.

45 IAC 15-5-7(f)(3) provides that there are five elements to fraud, by stating:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements of fraud.

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
- (B) Scienter: This is a legal term meaning guilty knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purposes of proving fraud.
- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.
- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions,

failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

In this case, all five elements are present. Misrepresentation of a material fact is present due to the fact that taxpayer failed to correctly report all information required by the Indiana Code and the Department's regulations. Taxpayer under-reported the sales for the years audited, which had the dual effect of reducing the sales tax to be remitted and reducing the amount of income tax based on the profit from those sales. Taxpayer did not file an Indiana tax return for 1997. 45 IAC 15-5-7(f)(3)(B) states, "Failure to file a return may be a misrepresentation."

Scienter is present due to the fact that taxpayer had actual knowledge of the responsibility of reporting actual income, as evidenced by the fact that taxpayer submitted returns in previous years. Those returns have a caption directly above the signature line, which states, "...under penalty of perjury, I have examined this return and all attachments and to the best of my knowledge and belief, it is true, complete and correct...". Taxpayer signed these returns knowing that the figures were incorrect. This is sufficient to establish scienter. Here, even looking at the facts in the light most favorable to the taxpayer, the consistent and long-term under-reporting of sales and failure to file a return in 1997 shows reckless making of statements without regard to their truth or falsity. As 45 IAC 15-5-7(f)(3)(B) states, "...the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for proving fraud."

Deception is present due to the fact that the Department had no reason to believe that the statements made by taxpayer, which were shown in the audit to be false, were not true. Reliance is present due to the fact that the Department relied, to its detriment, on the statements made by the taxpayer. Injury is present due to the fact that the Department was unable to collect the money which rightfully belonged to the state of Indiana. There is clear and convincing evidence that all five elements of fraud are present, therefore the penalty is appropriate.

### **FINDING**

Taxpayer's protest is denied.